

REVIEWS

THE FOREIGN TAX CREDIT. By Elizabeth A. Owens. Cambridge: The Law School of Harvard University, 1961. Pp. xxxi, 634. \$20.00.

THE foreign tax credit provisions of the Internal Revenue Code embody United States policy toward the taxation of the foreign source income of domestic taxpayers. By allowing credit for foreign income taxes paid, or considered paid, by domestic corporations, citizens and residents, the United States asserts only a secondary claim to the foreign source income of such taxpayers. In other words, foreign governments are regarded as having the primary right to tax income arising from sources within their borders up to the burden imposed by the United States. The foreign tax credit device thereby serves the dual purpose of eliminating double taxation and of maintaining tax equality between domestic taxpayers with only domestic source income and those with foreign source income. The credit system, however, does not work perfectly in all instances; the statutory provisions contained in five sections of the Code¹ have been subject to considerable controversy and many unanswered questions remain. These questions of law and policy are the main concern of *The Foreign Tax Credit*.

The scope of the work may be considered from a number of viewpoints. In the first place, it may be considered from the standpoint of how fully the problems of the foreign tax credit have been developed. Second, the scope of the treatment of important collateral areas may be appraised. Third, the book may be examined in terms of the depth of its analysis of common as well as the heretofore neglected problems. Finally, the study may be considered in light of its implications for legislative change.

I.

The study is, first of all, the definitive reference work on the foreign tax credit; definitive in the sense of fully developed. The main body of the work consists of nine chapters. The first chapter is a description of the basic statutory rules and of the tax and business decisions which the rules require. The second chapter critically examines the leading cases and rulings pertaining to the wide variety of foreign taxes which have been considered since 1918 for qualification for credit as income, excess profits, or war-profits taxes. Succeeding chapters deal with the indirect (deemed paid) credit available to domestic corporations, the problems of the taxable year, problems pertaining to the determination of who is entitled to credit, and the decisions dealing with the reporting of creditable taxes in terms of United States dollars. Such miscellaneous areas as the credit allowed resident aliens, treaty provisions, the reciprocal

1. INT. REV. CODE OF 1954, §§ 901-05.

relationship between foreign tax and United States tax, and administrative requirements for claiming credit are also fully considered. The final chapter is devoted to a broad discussion of the tax policy aspects of foreign source income in relation to the credit mechanism.

Chapter four—a treatment of the problems raised by the section 904 per-country limitation on the amount of available credit—deserves special mention. The back-breaking work of this lengthy chapter was concluded before the enactment of the elective over-all limitation in September, 1960. As a result it was necessary to provide an appendix to cover the new legislation. Such are the vicissitudes of hard cover works on federal income taxation.

In addition, a special appendix provides a listing on a country-by-country basis of all the recorded decisions and rulings dealing with the qualification of foreign taxes for credit. The work also contains a bibliography of most of the significant tax literature in the foreign income area, and a table of references covering cases, rulings, code and regulation provisions, forms, tax treaties, and legislative history sources. The topical index, unfortunately, is too brief; more detail would seem appropriate to the nature of the book as a reference volume.

On the substantive side, the study leaves nothing to be desired from the standpoint of full development of the problems of the foreign tax credit. If any problem has been neglected or glossed over, it is not readily apparent. As a tax law book, the study covers in full the legal and policy aspects of the foreign tax credit provisions of our basic revenue law.

II.

The Foreign Tax Credit may also be viewed from the standpoint of its coverage of problems closely related to those of the credit. The descriptive analysis of many of the related problems pertaining to foreign source income reveals the pervading character of the foreign tax credit provisions.

As an expression of policy, the foreign tax credit is designed to prevent the double taxation of the foreign source income of United States taxpayers. There must be repeated tests of this policy in the context of problems in related areas. In making these tests *The Foreign Tax Credit* turns out to be more than simply a text on the foreign tax credit. Consider, for example, the problems engendered by foreign currency devaluation and income blockage by foreign exchange control laws. In analyzing the application of the foreign tax credit in this area, it was necessary to describe the basic methods—profit and loss, balance sheet, and transaction—of converting foreign monetary units into dollars for income tax purposes.²

The pervading character of the credit may also be considered from the standpoint of the mechanical structure of the Code sections. For one thing, these provisions lack substantial definitional content. Therefore, problem solving often requires a reliance upon other Code sections. In drawing upon other areas, the book provides a coverage of problems going beyond the foreign tax

2. Chapter 7.

credit rules. For example, computation of the per-country limitation requires a determination of the amount of taxable income from within a particular foreign country. The source of income rules are provided in other sections of the Code.³ Thus, in considering this aspect of the law of the foreign tax credit, the book provides a descriptive analysis of geographic source of income rules.⁴ The discussion of the source rules applicable to royalty and dividend income is in substantial depth, and the twenty-three pages devoted to the allocation of deductions goes far beyond anything available elsewhere.

In the foregoing manner, Miss Owens has provided the tax bar and tax student with more than a study of the foreign tax credit provisions; the work could well be titled *The Foreign Tax Credit and Related Income Tax Problems*.

III.

Some students of federal taxation, however, may react to Miss Owens' work as did twelve-year old Johnny in reporting on a book devoted to penguins: "This book tells me more about penguins than I care to know." Only the most dedicated would care to pursue *The Foreign Tax Credit* hand-running, so to speak, from cover to cover. The book is hard-going and the multiple threads of thought are easy to snarl. Words of legislative history, statute, decision and ruling are often squeezed for their maximum in meaningful juice; alternative interpretations are sometimes suggested; and illustrations, examples, charts and formulae are injected. The analysis, in fact, goes beyond the average law review critique of the narrowest of tax problems. Few parts of the book escape the almost constant searching and probing into both the well-known and the neglected areas of the foreign tax credit.

Least I be misunderstood, these comments are made by way of commendation. Even the basic implication of the foreign tax credit provisions could hardly be recorded in simplicity without glossing over. Miss Owens can not be accused of this. The literature in this field of federal income taxation has been greatly enriched precisely because of the depth of her critical analysis.

IV.

Finally, *The Foreign Tax Credit* may be considered from the viewpoint of its implications for statutory reform. The volume contains policy material at both a technical and a general level. The technical material normally follows the descriptive and critical analysis of the various problems and is thus interspersed throughout the volume. For example, Chapter 2, dealing with the qualification of foreign taxes for credit, concludes with a section entitled "What Taxes Ought to Qualify For the Credit." The more general policy material is concentrated in Chapter 9, "Formulation of Income Tax Law With Respect to Foreign Source Income." This chapter is a general survey of the rules and policies governing the present treatment of foreign source income, and a critical

3. INT. REV. CODE OF 1954, §§ 861-64.

4. Chapter 4.

analysis of most of the statutory provisions granting preferential treatment to such income.

On May 3, 1961 Secretary of Treasury Dillon presented the Ways and Means Committee with a statement of the administration's recommendations on taxation.⁵ If the drafter of the foreign income section of the Secretary's statement had been bent toward footnoting, *The Foreign Tax Credit* could have provided most of the citations. The Secretary's statement outlines most of the major areas considered to merit correction in the interest of tax equity in the foreign income field and suggests techniques which could be used to effect the changes; *The Foreign Tax Credit* provides an articulation of substantially the same pleas for neutrality. This raises the question: how effective are such eloquent pleas for tax equity in the light of political realities?

Perhaps the high-water mark of post-war moves for additional tax concessions for foreign investment was reached in January, 1959 with the introduction of the Boggs Bill in Congress.⁶ The Boggs Bill started with a 14 point rate reduction for foreign source income and tax sparing (credit for foreign taxes not paid under foreign incentive plans), and ended up twenty months later passing the House with only a deferral privilege for business income from "less-developed" countries.⁷ Hardly a victory for the concessionists. To be sure there have been minor changes lessening the impact of taxation on foreign income, many of a technical "straightening-out" nature. Concessionists may list such post-war changes as indirect credit for royalties received in lieu of dividends, the 510 day rule exempting earned income of United States citizens physically present abroad, the carry-over of unused foreign tax credit, and more recently the elective overall limitation on the credit.

On the other hand, the political going of the neutralists has been even more difficult, probably because until the waning days of the 86th Congress their energy has been expended in rear guard action. And while they appear to be presently operating from a position of strength, there is evidence that Congress refuses to be stampeded in this direction also. For example, of the ten current administrative proposals dealing with foreign source income, the Ways and Means Committee appears to agree with only four changes, only one of which may be considered of major importance (grossing-up in computation of the indirect credit).⁸

While some of the administrative proposals may have been intended to be used for "trading" purposes (*e.g.*, the attribution of income of controlled foreign operating companies to United States shareholders), the struggle suggests that little ground has been found for compromise in recent years. Could *The Foreign Tax Credit* jar the pendulum in the direction of fresh, substantial gains

5. N.Y. Times, May 4, 1961, p. 1, col. 2.

6. H.R. 5, 86th Cong., 1st Sess. (1959).

7. *Id.*, as passed by the House on May 18, 1960, 106 CONG. REC. 10566 (1960).

8. See Ways & Means Committee, Print of Discussion Draft of "Revenue Act of 1961," §§ 4, 5 & 9 (Aug. 24, 1961); Staff of Joint Committee on Internal Revenue Taxation, General Explanation of Discussion Draft (Sept. 29, 1961).

for neutrality? It is doubtful, to say the least. While the book provides some refreshing analysis and a comprehensive treatment unavailable elsewhere, the main features of the neutrality arguments have been repeatedly presented to Congress. It is not likely that the new volume will have any immediate effect. A previous product of Harvard's International Program in Taxation, Barlow and Wender's *Foreign Investment and Taxation*, is often credited with influencing in large measure what ultimately became the "Foreign Business Corporation" in the Boggs Bill. However, the "Foreign Business Corporation" proposal was concessionary in nature and in its early stages drew substantial support from industry. The explicit and implicit proposals of *The Foreign Tax Credit* would require legislation which would increase the tax costs of operating abroad. And insofar as the current administrative proposals parallel those of *The Foreign Tax Credit*, active and vigorous industry opposition is in full swing.

But consider the possible long range effects. The volume brings together in scholarly form most of the policy considerations bearing on the making of value judgments at the technical level of the foreign tax credit mechanism, and at the general level of federal income taxation of foreign source income. For the neutralist, the book will be a joy to behold; a book for guidance in doing further battle against erosion of the income tax base. Concessionists, of course, will not care for its tone or philosophy. However, for neutralists and concessionist alike it could have a sobering effect because it portrays the need for study in depth of the factors bearing on the making of tax policy and tax law in the most complex of modern societies.

V.

In the final analysis, *The Foreign Tax Credit*, the thirteenth hard-cover product of Harvard's International Program in Taxation, constitutes an important contribution to the critical literature dealing with federal income taxation. If it has shortcomings it is only because time deals so harshly with almost all such efforts.

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IN DEFENSE OF PUBLIC ORDER: THE EMERGING FIELD OF SANCTION LAW.

By Richard Arens and Harold D. Lasswell. New York: Columbia University Press, 1961. Pp. x, 314. \$7.50.

The basic proposition put forth by the authors in this book is an apparently simple and convincing one: the sanction system of modern American society is operating at much below an optimum level, impairing many basic values which it should protect. Therefore, it should be subjected to systematic study, designed to improve its actual operation. Few will quarrel with this basic

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